

E-002/CI-93-6 ORDER REQUIRING FURTHER FILINGS REGARDING BIDDING
PROPOSAL

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
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In the Matter of an
Investigation into Establishing
a Bidding Process to Select
Resources to Meet the Future
Capacity Needs of Northern
States Power Company

ISSUE DATE: July 9, 1993

DOCKET NO. E-002/CI-93-6

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REGARDING BIDDING PROPOSAL

PROCEDURAL HISTORY

On January 12, 1993, the Commission issued its ORDER REQUIRING BIDDING PROPOSAL in Docket Nos. E-002/C-92-899 and E-002/CI-93-6. In that Order the Commission addressed a complaint filed by LS Power Corporation (LS Power) against Northern States Power Company (NSP or the Company). The complaint alleged that NSP had failed to negotiate or to enter into a contract for the purchase of power from a cogeneration facility that LS Power was proposing to build in NSP's service territory.

In discussions regarding the complaint, NSP indicated its desire to establish a bidding process for selecting the resources necessary to provide additional capacity in the future. In the January 12 Order, the Commission stated that it was prepared to enquire formally into the potential for bidding as a means of meeting NSP's future capacity needs. The Commission therefore ordered the Company to develop and submit a proposal for establishing a system of bidding to select resources to meet the Company's capacity needs. The Commission Order listed 14 questions which the Company should address in developing its proposal.

On February 1, 1993, NSP filed a proposal for implementing competitive bidding for long term purchase power contracts. NSP included responses to the questions raised in the Commission's January 12, 1993 Order.

On March 3, 1993, comments were filed by the Department of Public Service (the Department), the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), the Izaak Walton League of America (IWLA), District Energy St. Paul, Inc. (District Energy), Minnesota Power, the Regents of the University of Minnesota (the U of M), and the AES Corporation (AES).

Reply comments were filed on March 19, 1993, by NSP, the Department, the RUD-OAG, and Minnesota Power.

The matter came before the Commission for consideration on June 17, 1993.

FINDINGS AND CONCLUSIONS

I. NSP's Bidding Proposal

NSP's bidding proposal establishes a supply-side bidding program. Under the proposal, the need for new capacity, as well as the size and timing of resource additions, would be established through the Company's resource planning process. Many of the critical elements of the bidding proposal would be included in a generic Request for Proposals (RFP), which would be submitted on July 1, 1993, as part of the Company's resource plan. The important components of the bidding process contained in the generic RFP would include:

1. Specifications for capacity and/or energy resource requirements;
2. Guidelines and procedures for bidders;
3. Minimum threshold requirements for proposals;
4. Bid evaluation requirements and the associated scoring system; and
5. NSP transmission system interconnection requirements and standard contract terms;
6. A methodology for considering environmental factors in the bidding process.

In the Company's bidding filing, NSP stated that it would solicit bids from all sources of generation. Only when the Company solicits bids for renewable energy would the Company limit the bidding to renewable sources.

Under the Company's proposal, the generation section of NSP, NSP-Generation, would be allowed to compete in the bidding process. NSP stated that NSP-Generation has valuable experience in project development and the operation of generating facilities.

NSP's bidding proposal contemplated a third-party evaluator who would conduct initial screening and selection of bidders. First, the evaluator would screen all bids to determine if they satisfy written threshold requirements. Next, the evaluator would apply the criteria found in the generic RFP to create a short list of

bidders. Finally, NSP itself would apply the established bid criteria to perform the final evaluation and choose the winning bid.

The purchase power contracts awarded to successful bidders would be subject to regulatory review. If a certificate of need were necessary to implement the contract, NSP would make the contract contingent upon the Commission's granting the certificate.

Due to the high cost of participating in the bidding process, NSP proposed that developers of small projects of 50 MW or less be exempted from the process. NSP would work with these developers on a case-by-case basis, applying avoided costs derived from the bidding process.

NSP's proposal would exclude short-term capacity or energy purchases from the competitive bidding process. This would allow NSP to retain the operating flexibility associated with short-term capacity or energy purchases.

II. Comments of the Parties

A. The Department

The Department generally supported NSP's proposal to implement bidding for supply-side resources. The Department recommended approval of NSP's plan to link the bidding proposal with the resource planning process. Although the Department agreed with the Company that its generation section should be allowed to participate in the bidding, the Department recognized the need to safeguard against inappropriate self-dealing. The Department emphasized the need for timely bids, so that NSP could meet resource needs projected for 1998. Although the Department believed that most regulatory oversight should occur in the resource planning process, the Department recommended that the Commission review the RFP and winning bids.

B. The RUD-OAG

Although the RUD-OAG supported NSP's basic competitive bidding proposal, the agency raised a number of concerns regarding the process, including:

1. Insufficient opportunities for regulatory review during the bid evaluation process;
2. Unjustified and potentially damaging fees and other costs for bidders;
3. Undefined or vague evaluation criteria; and
4. Incomplete provisions against bias towards NSP in the bidding, evaluation, and bid selection processes.

In order to address these issues, the RUD-OAG recommended the following:

1. Increased regulatory review at critical stages of bid evaluation, especially in selecting the "short list" of bidders;
2. Collaborative definition of evaluation criteria, with separate, tested methods of evaluating cost and non-cost related attributes of alternative resources;
3. Optimization of costs and fees related to bid evaluation and performance security; and
4. Greater independence of bid evaluation, reduced financial barriers to entry, and increased objectivity of evaluation criteria.

C. The Izaak Walton League of America

The IWLA generally supported the bidding proposal submitted by NSP. The IWLA stated that the proposal struck the proper balance between ratepayer and shareholder interests, and between environmental concerns and competitive pressures in the generation markets.

The IWLA urged the Commission to require a collaborative process to assist in the development of NSP's generic RFP. The collaborative could address issues such as the treatment of environmental externalities in the bidding process.

D. District Energy St. Paul

District Energy stated that district heating and cooling, as well as cogeneration, should play an important role in the resource planning process. District Energy recommended the application of regulatory safeguards to ensure that projects other than those proposed by NSP receive fair consideration in the bidding process. District Energy questioned the proposed 50 MW threshold for bidding exemption. The agency recommended an exemption threshold of 20-25 MW, with the option of competing in the bidding process extended to any size project. District Energy supported full consideration of environmental externalities in resource planning and bidding through quantification of environmental costs.

E. The AES Corporation

AES has been developing a cogeneration facility and negotiating with NSP for the sale of the cogenerated electricity for over a year. AES urged the Commission to exempt it from any requirement to enter into the competitive bidding process, since it had already made a substantial commitment in time and finances negotiating with NSP.

F. The University of Minnesota

The U of M supported NSP's proposal to exempt small power producers from any competitive bidding process and to negotiate with such producers on a case-by-case basis.

G. Minnesota Power

Minnesota Power noted that its load and capacity needs are very different from NSP's. Minnesota Power urged the Commission to keep this in mind and to refrain from applying any precedent from this proceeding to Minnesota Power's situation.

Minnesota Power needs flexibility to market last-minute capacity and energy which are freed by its Large Power customers' cut-backs or shut downs. A competitive bidding process could limit Minnesota Power's flexibility.

Minnesota Power recommended that NSP's evaluative system take into account the fact that supply-side capacity has become available due to the implementation of a bidding utility's DSM programs. Socioeconomic factors should also be assessed.

Minnesota Power expressed concern regarding the amount of the security commitment required of bidders participating in the final evaluative process.

III. Commission Analysis

The Commission finds that the main objective of any bidding proposal is to identify reliable, environmentally sound and least-cost generation sources for a utility facing capacity needs. NSP's proposal is in general a reasonable approach to meeting such an objective.

The details of the bidding proposal will appropriately be considered in the context of NSP's resource planning process. When the Company files its generic RFP in conjunction with its proposed resource plan, it will supply more detail on such issues as bidding specifications, minimum threshold requirements, and transmission interconnection requirements.

At this time, the Commission has come to a determination regarding certain issues which have been raised and sufficiently explored by the parties. Most of these issues were included in the Commission's list of questions attached to its January 12, 1993 Order. For other issues, further information and parties' comments will be helpful before the Commission reaches a decision. Still other issues will be more appropriately addressed in connection with the Commission's analysis of NSP's generic RFP filing.

A. Issues which are here determined by the Commission

1. Consideration of NSP's bidding proposal on an individual basis

At the initiation of the LS Power complaint proceeding, NSP was already in the process of developing a competitive bidding or negotiation proposal. The necessity for such a process was made apparent by NSP's future capacity needs. In the January 12, 1993 ORDER REQUIRING BIDDING PROPOSAL, the Commission ordered the Company to complete its analysis of the bidding process and to submit a proposal that establishes a system of bidding for use in selecting resources to meet capacity needs.

The Company has complied with the Commission's directive and has submitted a proposal which addresses the issues raised in the January 12, 1993 Order. There is a need for a timely resolution of this matter, since bids must be sought, evaluated, and awarded, and projects must then be developed, to meet NSP's capacity needs by 1998. For these reasons, it is appropriate to address NSP's proposal in this docket rather than to pursue a generic investigation or rulemaking regarding competitive bidding.

The Commission has the option of further pursuing issues of competitive bidding on a general basis, either through a generic investigation or a rulemaking. At this time, the Commission will direct its attention to the specific issues raised by NSP as they apply to this utility's competitive bidding proposal.

2. Limitation of NSP's competitive bidding process to supply-side bidding

Commenting parties who addressed this issue agreed that it is appropriate to limit NSP's current bidding proposal to supply-side resources. The Commission agrees with this viewpoint. In these early stages of the competitive bidding process, it would be difficult to develop selection criteria which would apply equally well to demand-side and supply-side resources.

At some future date, the Commission may wish to consider a bidding process for demand-side resources. At this time, the Commission finds that the resource planning process is the best method for the Commission to analyze a utility's use of demand-side resources, as well as supply-side resources, and to monitor the overall procurement of these resources.

3. A separate RFP for renewable resources

Under NSP's bidding proposal, the Company would separate supply-side RFPs into two groups or "clusters." The first cluster would focus on general resource needs, without specifying fuel or technology preferences. The second cluster would be limited to renewable resources. Participants in the latter bidding cluster would also be able to bid on the former type of RFP.

The Commission notes that 1993 legislation requires Minnesota utilities to use renewable resources as the principal fuel in all new or substantially modified electric generating facilities, unless the Commission finds that using a renewable resource would not be in the public interest. Given the legislative emphasis on renewable resources, the Commission finds that separating renewable resources into their own bidding cluster in certain instances, where they need not directly compete with all-supply resources, may be appropriate. The Commission will therefore approve NSP's proposed clustering of RFPs for renewables or other specific resource types, when deemed necessary by the Commission in the Company's resource plan.

4. Development of the bidding program through the resource plan

Under NSP's proposal, the competitive bidding process will be integrated with the resource planning process. The Company will include its generic RFP in the resource plan which it submits for Commission approval. The generic RFP will set the basic parameters of the bidding process, including specifications for capacity and energy requirements, guidelines and procedures for bidders, minimum threshold requirements for proposals, the scoring system for evaluating bids, and other details necessary for an open and fair bidding process.

The Commission finds that consideration of the bidding proposal within the context of the resource plan is reasonable and appropriate. The resource planning process was created to address in a comprehensive fashion each utility's future capacity needs, and the options for meeting those needs. Because the competitive bidding process is meant to address the procurement of capacity, it is logically analyzed within the resource plan.

The RUD-OAG and the IWLA recommended that the Company's generic RFP be developed through a collaborative process. The Commission finds that the need for a timely resolution of this process, in light of NSP's real future capacity needs, renders a lengthy collaborative process inadvisable. The parties are free to file comments on the generic RFP in the Company's resource plan docket, and to collaborate on an informal basis at any time in the process.

5. NSP-Generation as a participant in the bid process

Under NSP's bidding proposal, the Company's generation division would be free to submit bids and to compete on the same basis as any other potential power supplier. No commenting party opposed allowing NSP-Generation to enter the bid process, and some noted the possible advantages of allowing bids from an experienced and historically reliable supplier. At the same time, a number of parties cited the need for heightened regulatory oversight in these circumstances.

The Commission finds that NSP-Generation may participate in the open competitive bidding process, as long as the proper regulatory oversight is in place. In a process meant to find the best and least cost source of capacity requirements, every reasonable power source should be available for analysis.

The Commission finds that certain changes to the proposed bid process will be necessary if NSP-Generation is allowed to enter the bidding process. First, regulatory review will be required on a higher level and earlier in the process. The criteria for evaluation, including threshold requirements for initial screening, should be clarified and promulgated to interested parties.

Second, an information exchange between the parties may need to be facilitated if NSP-Generation is considered as a bidder. In such a situation, in which NSP both submits a bid and determines the winning bidder, the Commission may need to monitor discovery requests from other parties, and perhaps adjudicate discovery disputes.

Third, allowing NSP-Generation to enter the bidding process could raise issues unique to the ratemaking process. A regulated utility is allowed recovery of prudently incurred expenses associated with service to ratepayers. The potential for eventual recovery in rates could encourage competitive underbidding from a regulated entity such as NSP-Generation. This issue will need to be addressed in NSP's compliance filing, and modifications may need to be made.

The Commission will require NSP to address the aforementioned issues, as well as others surrounding NSP-Generation's potential status as a bidder, in its compliance filing.

B. Issues which will require further information and comments

1. Qualifying facilities and the bidding process

A number of issues have been raised regarding the relationship of qualifying facilities (QFs) and NSP's bidding process. NSP has asked the Commission to require QFs to participate in the bidding process for most projects, if the QFs wish to receive capacity payments for their projects. AES has asked the Commission to find that it is exempt from any bidding procedure requirements. The Department has asked how we treat QFs that are currently negotiating with NSP, as the utility moves toward a competitive resource procurement environment. If avoided costs are established through the bid process, would NSP be free to choose to award a contract either to a winning bidder or to a QF at the established avoided cost?

The Commission finds that more information is necessary in order to analyze and answer these and other questions raised in the development of the bidding process. The Commission will

therefore require NSP to comment on certain questions in a compliance filing. Interested parties will be free to file reply comments. NSP must address, at a minimum, the following questions:

1. Can the Commission restrict capacity payment for QFs to the bidding process? What happens if a QF offers capacity at or below the most recently determined avoided cost just prior to a bid solicitation?
2. What is the status of QFs which are not successful in a bid solicitation, but still desire to sell energy and capacity to NSP?
3. What is the status of QFs which are not successful in the negotiations surrounding the LS Power docket?

2. The 50 MW bidding threshold

Under NSP's proposal, developers of projects generating 50 MW or less would not be required to participate in the bidding process. NSP stated that participation in the bidding process would not be cost-effective for small power producers. NSP expressed its intention to work with these developers on a case-by-case basis.

Commenting parties have raised a number of issues regarding the 50 MW threshold. The Department and others have questioned the wisdom of setting the threshold this high. Minnesota Power asked for clarification of the manner in which small power producers will fit into the resource selection process.

The Commission finds that parties have raised important questions which must be analyzed and addressed. Because the Commission requires further information for its analysis, the Commission will require NSP to submit a compliance filing addressing the selection of 50 MW as a threshold, and other related issues.

3. The Power Purchase Contract Exclusion

Under NSP's bid proposal, the Company would exclude from the competitive bidding process any capacity or energy purchases of less than five years in duration. The Company stated that this exemption would provide it the necessary flexibility to take advantage of favorable short-term purchases.

The Commission finds that the goal of obtaining reliable, environmentally sound, and least cost generation sources may require procurement flexibility not found in any competitive bidding process. The Commission will need further information in order to determine the proper balance between the advantages of an open competitive bidding process and the need for flexibility for utility operations. The Commission will therefore require the Company to file an explanation of its choice of five years as a threshold for exclusion from the bidding process.

C. Procedural issues

NSP's 1993 resource plan proposal will be filed on July 1, 1993. Under NSP's bidding proposal, the Company's generic RFP would also be filed on July 1, in conjunction with the resource plan filing.

At the June 17, 1993 meeting, the Company asked for a time extension until July 30, 1993 in which to file its generic RFP. NSP explained that the important issues raised in the development of the competitive bidding process required further time to explore. NSP also asked the Commission to require a collaborative process among the Company and other parties interested in NSP's competitive bidding process. The collaborative would meet informally at least once before NSP attempted to provide written answers to the questions posed by the Commission in this proceeding. After the meeting or meetings of the collaborative, the Company would provide the requested written comments, and reply comments would be allowed.

The Commission finds that NSP's request for an extension of time in which to file its generic RFP is reasonable and should be granted. The Commission recognizes that the competitive bidding process is a new procedure in Minnesota, and requires extensive research and planning. The Company has put in considerable effort thus far, and should be allowed sufficient time to complete its development of the plan.

The Commission will not, however, form a collaborative or require it to meet regarding these issues. Most parties to this proceeding, including the Company, have emphasized the need for a timely process which will allow NSP to procure its capacity needs before they would affect Company operations in 1998. The Commission does not feel that a side venture into a collaborative would allow sufficient time for a plan to be approved, bids to be submitted and awarded, and projects to be constructed by 1998.

The Commission notes that parties are free to pool their knowledge and to collaborate in the development of this or any other competitive bidding process. Parties are encouraged to cooperate in this effort, which should ultimately assist any entity which will be involved with the competitive bidding process. The Commission will not, however, require a collaborative to meet during this process.

D. Issues which must be addressed in conjunction with the Commission's review of NSP's generic RFP

The generic RFP will define many key elements of NSP's competitive bidding proposal. For this reason, the Commission will wait until the generic RFP has been filed, and comments have been submitted regarding it, before it will decide certain issues raised in this proceeding. Some of these issues are listed below.

1. Specific bid criteria;
2. Issues related to transmission access;
3. Effects of power purchases on a utility's capital structure;

Section 712 of the federal Energy Policy Act requires the state regulatory commissions to consider the implementation of standards for wholesale electric power purchases. On June 17, 1993, the Commission opened a docket to consider the issues raised by this section of the Energy Act. Docket No. E-999/CI-93-207. A determination regarding standards must be made by the Commission by October, 1993.

Provisions of the federal Energy Act could relate to the establishment of evaluative criteria in NSP's bidding process. NSP has requested that the conclusions reached in the generic investigatory docket be incorporated into NSP's first generic RFP. For these reasons, the Commission will direct NSP not to include anything related to an equity adjustment in its generic RFP to be filed on July 30, 1993. When conclusions regarding the financial impact of wholesale power purchases have been reached in the generic docket, they can be incorporated into NSP's RFP.

4. Certificate of need/state siting process and the effect on a competitive bidding process;
5. Multijurisdictional approval/cooperation.

The Commission will require the Company to file certain information listed in the following ordering paragraphs as a supplement to its resource proposal in Docket No. E-002/RP-93-630. The information will be due on the same date as the generic RFP, July 30, 1993.

ORDER

1. On or before July 30, 1993, NSP shall file its generic RFP in conjunction with its resource planning filing, Docket No. E-002/RP-93-630 (due July 1, 1993). If the generic RFP is approved by the Commission, the Company shall proceed to develop a specific RFP.
2. On or before 45 days from the date of this Order, NSP shall submit a compliance filing addressing (but not limited to) the following questions or issues:

- a. Can the Commission restrict capacity payments for QFs to the bidding process? What happens if a QF offers capacity at or below the most recently determined avoided cost just prior to a bid solicitation?
- b. What is the status of QFs which are not successful in a bid solicitation, but still desire to sell energy and capacity to NSP?
- c. What is the status of QFs which are not successful in the negotiations surrounding the LS Power docket?
- d. Provide information regarding the 50 MW cutoff for those projects that are not required to participate in the competitive bidding process;
- e. Provide an explanation of the selection of a five-year contract term as an exemption threshold for the bidding process;
- f. Modify and resubmit the bidding proposal to include formal Commission review of the initial bid evaluation. In bids where NSP is a competitor, NSP should address whether the process should be designed so that bid evaluation results are reported directly to the Commission;
- g. Clarify the threshold requirements upon which bids will be rejected in the initial screening done by the third-party evaluator.
- h. Propose a method for working with the third-party evaluator in selection of the final bid;
- i. Propose a method for involving the resource plan collaborative or some other similar group in the selection of the third-party evaluator;
- j. Provide more detail on the Company's plan to ensure that personnel in the bidding and evaluating divisions of NSP operate independently;
- k. Describe the process the Company will use to allow for information exchange between NSP and the bidders;
- l. Propose a method to ensure that if the Company's generation section wins a bid, the cost of the project as implemented will not exceed the bid price;
- m. Clarify how the Company intends to handle foreign entities such as Manitoba Hydro and bidders from outside the state in the bidding process;

- n. Describe the optimal time line for approval of a generic RFP, issuance of a specific RFP, and bid selection and construction, given the current timing of projected need for capacity in 1998 or before.
- 3. Parties who wish to file comments on NSP's compliance filing shall do so within 20 days of its filing.
- 4. On or before July 30, 1993, the Company shall file the following information as a supplement to its resource plan filing in Docket No. E-002/RP-93-630:
 - a. Explore contractual alternatives to performance security fees, and present these in a draft contract for regulatory review;
 - b. Clarify as fully as possible the criteria for and means of evaluating the financial and business viability of bidders, and the way this evaluation will be used in accepting or rejecting bids;
 - c. Provide justification of the \$5,000 fee for bid evaluation and the \$4.00 per KW security commitment fee;
 - d. Explain further any problems associated with transmission access, and the Company's role in assisting bidders with these problems. Specifically, explain the process for disclosure of transmission information to allow bidders to design competitive bids and the Company's role in wheeling assistance.
- 5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)